INSURANCE INFORMATION INSTITUTE

Q3 SUMMARY | Q4 EXPECTATIONS

The pace of COVID-19 infection and casualties is accelerating. As of publication, the virus has claimed 1,267,780 lives and infected 51,211,972 people worldwide. Far from losing speed, this is an increase of 50% in casualties and more than 100% in infections in the last 3 months alone. The U.S. continues to top the list of most impacted countries, followed by India, Russia, Brazil, France, Spain, Argentina and the U.K. As expected, with a relaxation of lockdowns during the summer, global economic activity recovered from its double-digit Q2 contraction to a current consensus of between -4.5% to -7.0% year-over-year GDP decline for 2020. The extent of new lockdowns, the success of vaccine trials and the efficacy of vaccine distribution will determine when the pace of economic recovery in 2021, with consensus pointing to Q3 or Q4 2020 as rounding the corner out of the pandemic part of the recession. However, economic activity will not heal and recover until well into 2021 and early 2022. On the downside, global premium growth is being depressed by contracting economic activity but on the upside is experiencing increases in pricing and market hardening, pointing to flat-to-increasing premium growth going into 2021.

GLOBAL MACRO OUTLOOK

Growth and Inflation

In October 2020 the IMF raised its baseline global GDP forecast for 2020 to -4.4%, a slight improvement from its earlier forecast of -5.5%. The OECD also raised its G20 forecast for 2020 to -4.5%, a slight improvement from its earlier forecast of -4.7%. The IMF appears more bullish than the OECD about emerging markets. Both the IMF and OECD forecast improvements are due to smaller than expected contraction in the U.S., Europe and China, although the reported estimate of nearly 2% GDP growth in China is unconvincing. Neither the IMF nor the OECD forecast factored in Q4's quickening rate of COVID-19 infection and casualties. Concerns over deflation remain in Eurozone, oil producing states and several emerging markets where prices are declining by -0.3% to -2.5%.

Taking into consideration the IMF, OECD, and other benchmark forecasts, our estimate is unchanged from the last quarter, and we expect that global GDP will contract between -5.5% and -6.5% in 2020. We continue to view the IMF baseline for 2020 and for 2021 as overly optimistic, especially the Q3 assumption of a slowdown in both the COVID-19 infection rate and casualties in Q4 2020 which has proven inaccurate. Recent announcements about a vaccine, for example from Pfizer, are in line with the earlier Q2 and Q3 2020 consensus that progress toward a vaccine would accelerate in Q4, with early successes and commercial distribution in Q1 and Q2 2021. Pfizer said it would be ready to distribute nearly 30 to 40 million vaccines —enough for 15 to 20 million people —by late January. Under best scenarios, economic growth will not start to fully recover until Q2 and Q3 2021 in advanced economies and Q3 and Q4 in developing economies.

Monetary and Fiscal Policy

With little room to go lower, global central banks continued to keep benchmark interest rates on hold going into Q4 2020 at an average of 0.6%. The real action is focused on bond purchasing as a way to deliver liquidity to financial markets. For example, on November 5 the Bank of England announced that it would now spend US$1.3 trillion on bond purchasing as the U.K. gears up for new lockdowns while keeping its benchmark interest rate at 0.1%. The ECB and the U.S. Fed have already renewed their commitment to further bond purchasing especially as appetite for further fiscal stimulus has decreased across governments.

Financial Markets

The consensus among policymakers and financial markets analysts is that the continuation of low interest rates and further bond purchasing will support further rallies in equity. In our view, such an expansive influx of liquidity into financial markets, and the expanding push along the risk curve toward greater higher risk equity exposure and away from lower risk fixed income instruments raises concerns about equity froth and the impact of market corrections on households' financial stability, especially when household liquidity is under stress due to historically high unemployment.

The recovery in commodity prices continues to lag that of equity markets and remains more closely linked to actual GDP growth and, in our assessment, a better indicator of the economy's overall performance than equity prices. For example, Oil (Brent) has recovered from its low of -59% year-to-date but is still -32% year-to-date as of November 10th. That said, agricultural commodities have returned to positive territory for the year. For example, soybeans, which were down -5% year-to-date as of August 30th is now up +19% for 2020 as of November 10th.

Premium Growth

Global premium growth is a factor of economic activity, pricing and insureds' behavior surrounding retention and limits. The only conclusive premium growth driver so far for 2020 is reduced economic activity; the impact of losses and pricing has yet to be determined.

All things being equal, higher economic activity drives premium growth higher while lower economic activity drags premium growth down. Going into Q4, economic activity, expressed as year-over-year change in GDP for the world's 10 largest insurance markets, is expected to decrease by -4.5% in 2020, compared to our previous Q3 estimate for 2020 of -6.9% and Q2 estimates for 2020 of -4.9%. This estimate is based on current IMF GDP forecast for all top 10 countries with the exception of the forecast for the U.K. which is from the Bank of England.

Top 10 Insurance Markets Growth
GDP Change Year-Over-Year 2020

Rank	Country	Global Share	GDP YoY (%)
1	U.S.	49%	-4.3%
2	China	12%	+1.9%
3	Japan	9%	-5.3%
4	U.K.	7%	-11.0%
5	France	5%	-9.8%
6	Germany	5%	-6.0%
7	South Korea	3%	-1.9%
8	Italy	3%	-10.6%
9	Canada	3%	-7.1%
10	Taiwan	2%	+3.4%
		2020 GPD Growth YoY:	-4.5%

Reference: Market Share

Return on Investment (ROI)

The trend toward structurally low interest rates continues into Q4 2020 while further central bank bond purchasing keeps pressuring fixed income yields downward. Structurally depressed interest rates, especially in the U.K. and continental Europe, will continue to exert upward pressure on insurance premium. We expect this trend to continue to impact Europe-based insurance companies more so than their U.S., Asia, and Pacific-based counterparts. Expectations of a vaccine becoming available in 2021 may lead to a reduction in market volatility going into Q1 2021. This may enable insurance carriers to increase exposure to equity and other non-fixed income assets away from fixed income.

Insurance Pricing

Insurance pricing tends to be driven by returns on investments and claims. Lower economic activity due to COVID-19 is expected to lead to decreased claims in 2020, especially for residential property and auto. Combining lower returns on investments and lower claims expectations, the consensus among insurance analysts is that pricing will remain flat in 2020, with most premium increases taking place in 2021. However, recent data from Marsh shows significant increases not only for casualty but also perhaps more surprisingly for property.

According to Marsh's Global Insurance Market Index for 2020 Q3, global premium prices for the largest insurance products increased 20% in Q3, the largest quarterly year-over-year increase since the report's inception in 2012. Across regions, the U.K. reported the highest growth (+34%) followed by the Pacific (+33%), the U.S. (+18%), continental Europe (+15%), Asia (+12%), and Latin America (+9%). Across products, global financial and professional liability had the largest increase (+40%), followed by global property (+21%), and global casualty (+6%). Within countries or regions, U.K. prices increased for property (+20%), casualty (+6%), products liability (+67%), public D&O (+100%), and cyber (+17%). In continental Europe property prices were up (+21%) driven by CAT exposures in France, Germany, and Spain while casualty prices were also up (+5%) driven by general liability (+24%) and excess lines, especially for companies with North American assets. In emerging markets, property prices were up in the Pacific (+31%), Asia (+18%), and Latin America (+15%). Casualty prices were up in the Pacific (+11%) and Asia (+1%), but down in Latin America (-4%).

That said, the relationship between pricing and premium growth is less direct than that of changes in GDP and premium growth and is mitigated by insureds' decisions to increase or raise retention and limits in response to changes in pricing. While increases in pricing may cause premium growth, their impact on premium growth can be mitigated and even reversed if insureds opt for cost savings by, for example, increasing retention or lowering limits. Marsh's reports points to a significant share of insureds around the world doing just that, possibly mitigating the impact of rising prices on premium growth. More relevant data will become available in Q1 and Q2 2021.

Business Interruption Insurance

The U.K. High Court issued a decision in favor of policyholders in a test case brought by the country's Financial Conduct Authority (FCA) against insurers providing business interruption insurance. A summary of the judgment may be found on the FCA's legal team's website. The court's decision follows in the footsteps of decisions by courts and regulators in France and Ireland that have largely favored policyholders.

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